Office of Chief Counsel Internal Revenue Service

memorandum

CC:LM:CTM:SF:POSTF-115054-02 KGCroke (LMSB)

date: April 22, 2002

to: David Schwarcz, Team Manager

from: CC:LM:CTM:SF

subject:

Inc. and Subsidiaries

POSTF-115054-02

This memorandum responds to the request for assistance dated March 4, 2002 from Harry Potter. This memorandum should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUE

Is the preemptive right in an Option Agreement a nonlapse restriction under I.R.C. § 83(d)?

CONCLUSION

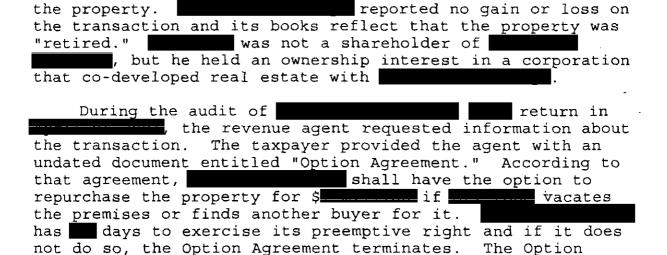
The preemptive right is not a nonlapse restriction because it is not permanently attached to the property.

FACTS

			is a	ı su	bsi	dia	ry of						
Inc.				is i	n t	he	real	est	ate	dev	relopm	ent	
business.	On			,					_1	trar	<u>ısfer</u> r	ed t	:he
ownership	of r	eside	ential.	pro	per	tу	locat						
president,	,										quired		:
property	У	rears	previo	ous	for	\$			ā	and	owned	it	

Agreement was not recorded.

free and clear.



paid

Although the agreement is entitled "Option Agreement" it conveys a preemptive right. There is a well recognized legal distinction between an option and a preemptive right. As stated in 6 American Law of Property, §§ 26.64, p. 507 (A. J. Casner ed. 1952):

A pre-emption does not give to the pre-emptioner the power to compel an unwilling owner to sell; it merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the pre-emption, at the stipulated price. Upon receiving such an offer, the pre-emptioner may elect whether he will buy. If he decides not to buy, then the owner of the property may sell to anyone.

It is not at all clear that the Option Agreement was executed concurrently with the property transaction.

's financial statement for references the Option Agreement, but it was prepared at the time of the audit and the reference may have been inserted as a result of the agent's inquiry. Importantly, however, the financial statement for the year of the transaction, makes no reference to the Option Agreement. The revenue agent will request the date the Option Agreement was executed in an IDR.

LAW

Section 83 of the Code provides the rules for the taxation of property transferred to an employee in connection with the performance of services by such employee. Section 83(a) of the Code provides in part that the excess of the

fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the time the rights of the person in the property are first transferable or no longer subject to a substantial risk of forfeiture, over the amount paid for the property, shall be includible in the employee's gross income for the taxable year in which the property becomes transferable or ceases to be subject to a substantial risk of forfeiture, whichever is earlier.

I.R.C. § 83(d) provides that in the case of property subject to a nonlapse restriction and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be the fair market value of the property unless established to the contrary by the Commissioner. Treas. Reg. § 1.83-3(h) defines a "nonlapse restriction." It provides that a nonlapse restriction is a permanent limitation on the transferability of property (i) which will require the transferee of the property to sell, or offer to sell, such property at a price determined under a formula, and (ii) which will continue to apply to and be enforced against the transferee or any subsequent holder (other than the transferor). The term "lapse restriction" means a restriction other than a nonlapse restriction and includes (but is not limited to) a restriction that carries a substantial risk of forfeiture. Treas. Req. § 1.83-3(i).

DISCUSSION

The restriction in this case is not a nonlapse restriction.

is required to offer the property to if he vacates it or intends to sell it.

has days to exercise its preemptive right.

If many does not exercise its right within the day period, the Option Agreement terminates.

can then sell the property and the new purchaser is not subject to the restriction. Treas. Reg. § 1.83-3(h)(ii) requires that a restriction continue to apply to and be enforced against the transferee or any subsequent holder to qualify as a nonlapse restriction. The restriction at issue would not apply to any subsequent purchaser and is therefore not permanently attached to the property. Consequently, it is not a nonlapse restriction.

The fact that the Option Agreement was unrecorded offers further support to the conclusion that the preemptive right is not a nonlapse restriction. The Option Agreement is an instrument affecting real property. Phipps v. CS Leasing,

Inc., 923 P.2d 863 (1996). Ariz. Rev. Stat. §§ 33-411(A) provides that no instrument affecting real property gives notice of its contents to subsequent purchasers for valuable consideration without notice, unless recorded as provided by law. Ariz. Rev. Stat. §§ 33-412 provides that an unrecorded instrument is void as to bona fide purchasers or creditors, but is valid and binding as between the parties and their heirs and as to all subsequent purchasers with notice of the agreement, or without valuable consideration.

(b)(5)(AC), (b)(7)a		
	_	
(b)(5)(AC), (b)(7)a		
	•	

LAUREL M. ROBINSON
Associate Area Counsel
(Large and Mid-Size Business)

Ву	:		<u> </u>	
_	KEVIN	G.	CROKE	
	Attori	ney	(LMSB)	